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INFORMAL SECTOR:  
CONCEPT AND POLICY

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## INFORMAL SECTOR : CONCEPT AND POLICY

T.S. Papola

It is well known that a major part of the economies of developing countries consists of small and tiny production organisations mostly run on an informal and self-employment basis. While rural and agricultural activities are almost entirely carried out on this basis; a significant part of the economic structures of the urban and industrial sectors are also found to consist of the non-organised units. The established doctrines of development tend to view these forms of production organisations as transitory, and postulate their gradual disappearance with the emergence and growth of large formalised organisations as a necessary concomitant of the technological and market compulsions of modern development. Despite considerable advance towards industrialisation and modernisation, however, most of the cities and industrial centres in the developing countries have continued to have a large, and in some cases, increasing proportion of their activities in the non-formal and non-organised units. This phenomenon has led some observers to advocate a strategy of development emphasising the non-formal and non-organised sector as the focal point, as an alternative to the widely used strategy relying on technological and organisational modernisation and large scale of production units.

The argument for the above alternative is primarily based on the two presumed characteristics of the non-formal

sector. One, its size is quite large in most of the important urban settlements in developing countries : it is estimated that over 60 per cent of the employment in Nairobi<sup>1</sup> and Kumasi<sup>2</sup>, 50 per cent in Jakarta<sup>3</sup> and around 45 per cent in Calcutta<sup>4</sup>, Bombay<sup>5</sup> and Ahmedabad<sup>6</sup> is to be found in this sector; and it seems to have been increasing rather than declining. A strategy of development emphasising growth of organised sector puts enterprises in the non-formal sector to a disadvantage thus denying them the opportunity to contribute to growth to the full extent of their potential. Therefore, it is argued, it is only appropriate and economical to use the organisations in the non-formal sector for development, rather than dismantle them to build costlier structures. Second, it is presumed that this sector makes a

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1. ILO . Employment, Income, and Equality : A Strategy for Increasing Productive Employment in Kenya, Geneva, 1972.
  2. ILO : Employment Problems in the Rural and Informal Sectors in Ghana, Report of an ILO/JASPA Mission, Addis Ababa, 1977.
  3. S.V. Sethuraman : Jakarta : Urban Development and Employment, ILO, Geneva, 1976.
  4. Harold Lubell : Urban Development and Employment : The Prospects for Calcutta, ILO, Geneva, 1974; and A.N. Bose : The Informal Sector in Calcutta Metropolitan Economy, ILO, Geneva, 1974.
  5. Heather and Vijay Joshi : Surplus Labour and City : A Study in Bombay, Bombay, 1976.
  6. T.S. Papola : Informal Sector in an Urban Economy : A Study in Ahmedabad, GIDS, Lucknow, 1979 (Mimeo).

greater use of abundantly available human labour, due to the lower capital intensity of production; with no rigid bars on entry, the employment in this sector, is more accessible to those lacking economic and social endowment; and, the informal structure and small size of the production organisations render a humane character to the social relations of production in these organisations. Growth based on the non-formal organisations is, therefore, presumed to be more effective in tackling the problems of unemployment, poverty and inequality.

It is in the above context that the concept of 'informal sector' has been used to describe the non-organised small sector, in the literature on development and employment, during the last few years. Most of the literature using this concept has flown from the studies undertaken under the auspices of international bodies like the ILO and the World Bank and makes a plea for a better deal for the 'informal sector' than it has so far received in the developing countries, emphasising its greater suitability for solving the problems of poverty and unemployment. The present paper attempts to examine the concept of informal sector as an analytical category within the widely used dichotomous frame for describing the economic structures of urban areas of developing countries, and the implications of the informal sector based strategy of development. Specifically, it raises the following issues: Is a dichotomous frame adequate for dealing with the problems of analysis and policy on the structures of urban economies? What constitutes the informal

sector ? Is it possible and useful to delineate it for the purposes of analysis and policy ? Can the emphasis on informal sector be taken as an integral part of the long term development strategy ? These issues are examined here on the basis of a critical review of literature on the subject without a detailed empirical verifications of the propositions and hypotheses and policy overtones underlying the concept of informal sector which has been attempted, to some extents by the author elsewhere (reference cited in footnote 6).

#### I. Dichotomy in Urban Economies

The dualistic nature of urban economies has been used as a frame of analysis of economic structures and labour markets for quite some time now. Various classifications such as organised and unorganised, modern and traditional, capitalist and subsistence sectors have been used for analysing the urban economies; while distinction between organised and unorganised, protected and unprotected, and regular and casual workers, has been used for analysing urban labour markets. Over and above, the large-small dichotomy has also been used very frequently, sometimes with precise cut-off points of size of capital and employment, but more often, in a vague and general sense. And formal-informal sector classification is the latest to arrive on the scene and has had a wide clientele for over five years now. All these dichotomous frames emphasise the fact of discontinuities in urban economic organisations and are utilised to reveal and analyse distinguishing characteristics of the

two sectors, quite often with a view to highlighting policies for growth of one sector in contrast with the other. Not many attempts have, however, been made to study the inter-linking and integration of the two sectors.

Despite the widespread use of the two way classification of urban economic organisations, it is also well recognised that the distinction is not always analytically clear, nor is it operationally usable for all purposes. In the first instance, it is argued, with substantial force, that there is a continuum of production activities; and, division of an urban economy into two parts is arbitrary. In fact, the unorganised or informal sector enterprises may be in the process of transition and with time they would graduate to the other sector, thus leading to the disappearance of discontinuities.<sup>7</sup> According to another view, which recognises the existence and persistence of discontinuities, the dichotomous classification is inadequate, as there are more than two well distinguishable sectors; for example, the informal sector itself could be broken down into two sub-sectors : an irregular sector and the informal sector proper.<sup>8</sup> In fact, the very

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7. Louis Eummerij, "A New Look at Some Strategies for Increasing Productive Employment in Africa", International Labour Review, September 1974.

8. Guy Standing : "A Trichotomous Model of Urban Labour Markets", in Subbiah Kanappan (ed.) Urban Labour Market Behaviour in Developing Countries, International Institute of Labour Studies, Geneva, 1977; also T.S. Papola, "Typologies of Labour Markets within an Urban Labour Market", ULM/DP/9, Research Conference on Urban Labour Markets in Developing Countries, International Institute of Labour Studies, Geneva, October 1974.

wisdom of defining two sectors of an urban economy has sometimes been questioned on the ground that the researchers try to fit the empirical material into their intuitively fixed categories and characteristics; and such a priori determination of the analytical frame may not be reliable in so far as it tends to ignore the relations between the sub-sectors which may be most crucial in determining the functioning of the urban economy as a whole.<sup>9</sup>

It is, however, possible to incorporate the above points in the analysis of urban economies, within a dichotomous frame of reference. The hypotheses relating to the continuum, subsectors within sectors, and interrelationships between the sectors should, as a matter of fact, form an integral part of any attempt to study the structures of an urban economy. That does not reduce the usefulness of the two-sector frame as a starting point of analysis. What is, in fact more important, is the way in which the two sectors are defined; and the analytical veracity and operational usability of the distinction. It is, therefore, worthwhile to look at the various classifications used from time to time, and examine how the latest of them - formal-informal sector dichotomy - is made to have advantage over others.

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9. Chris Gerry, Petty Producers and Urban Economy : A Case Study of Dakar, Geneva, ILO, 1974 (Memo). Jan Breman emphasises the segmented nature of the entire labour market rather than divide the urban system into two sectors : Jan Breman : "A Dualistic Labour System : A Critique of the 'Informal Sector' Concept", Economic and Political Weekly, November 27, December 4 and 11, 1976, pp. 1939-1944.



The most commonly used classification is the one which divides the economy into organised and unorganised sectors. As a classification of economic activities, one would intuitively presume that the distinction refers to the fact of organised or unorganised character of producers. In fact, however, it has not meant so; the distinction has been made on the basis of certain empirical facts of size, nature of market and relation with the State. In one of the most recent attempts to distinguish between the two sectors, Heather and Vijay Joshi have laid down the following distinguishing characteristics of the two sectors<sup>10</sup> : One, the organised sector "contains large manufacturing firms operating in oligopolistic markets sheltered from foreign competition by high tariffs and quantitative restrictions, selling their products mainly to middle and upper income groups. The unorganised sector contains a very large number of small producers operating on narrow margins in highly competitive product markets; selling a variety of goods and services ..... mainly to low income groups" (emphasis added). Second, the organised sector firm use capital intensive, imported technology, in contrast to labour intensive indigenous technology used by unorganised sector producers; labour productivity in the former is, therefore, much higher than in the latter. Technology of the organised sector firm require routinised and formalised work conditions, while the work situation in the unorganised sector is quite informal.

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10. Heather and Vijay Joshi, op cit, pp.44-46.

Third, the organised sector firms have access to and influence over the machinery of the Government, and, therefore, to official protection and benefits, which are not available to the unorganised sector producers. Similar is the case with finance and credit from the organised banking sector.

The above description does well to highlight certain basic distinguishing characteristics of the two sectors. But like all other attempts to distinguish, there are two basic problems, with the bases of classification proposed by Joshi. One, some of the central variables like size, degree of competition in the product market and capital intensity of technology are continuous variables and do not permit a clear discontinuity at the point of division. Second, since the attribute of the degree of organisation does not enter into the classification as a basic distinguishing characteristic, designating it as 'organised-unorganised' dichotomy has no special significance; it could as well be termed 'large-small', 'modern-traditional', or 'capital intensive-labour intensive' activities. The scheme, however, does provide a reliable and usable basis for classifying the workers and the labour market. As Joshi point out, a salient feature of the organised sector is its relatively protected workforce and the major source of this protection lies in the unionised character of the workforce of this sector. This characteristics had been highlighted in

the analysis of labour markets, among others, by Dipak Mazumdar.<sup>11</sup> Besides unionisation, there are other characteristics of the organised sector such as application of certain legislations, formalised character of recruitment etc., which provide protection to workers in this sector in matters of conditions of work and wages. Workers from the unorganised sector find it difficult to cross the barriers of entry to the organised sector. These factors make the distinction between the two sectors rather sharp so far as the labour market behaviour is concerned, but they leave the distinction between the two sectors of economic activities rather blurred.)

Mode of production, capitalist and subsistence, has also been used sometime as a basis of classifying urban production organisation. According to McGee, "most cities in the Third World can be seen as consisting of two juxtaposed systems of production - one derived from capitalist forms of production,

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11. Dipak Mazumdar, 'Notes on the Informal Sector' in Subbiah Kanappan, (ed.) op cit; and Dipak Mazumdar, The Urban Informal Sector, World Bank Staff Working Paper No. 211, Washington, 1975.

the other from peasant system of production".<sup>12</sup> The classification based on this approach could well take care both of the economic activity and labour market distinction between the two sectors simultaneously. This approach has, however, not found much favour with the researchers in the field primarily for two reasons. One, the research workers seem to have easily given in to the skepticism expressed by its critics that in the developing economies most of the production organisations are not amenable to the classification based on modes of production and most of the producers are not easily classifiable as either capitalists or wage earners. Second, the Marxist scholars have not found the theme of the structure of urban economies interesting enough, and non-Marxist scholars have mostly shown an abhorrence to the use of concepts like classes or mode of production. As a consequence, the scholars have preferred the use of

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12. T.C. McGee, "Peasants in the Cities : A Paradox, a Paradox, a Most Ingenuous Paradox", Human Organisation, (Washington), Summer 1973, p.138, Breman (op cit. p.1875) favours the distinction based on mode of production. Bienefeld uses the distinction between capitalist and pre-capitalist modes of production, but emphasises their interaction and ultimate integration into a capitalist system. See Manfred Bienefeld 'The Informal Sector and Peripheral Capitalism : The Case of Tanzania', IDS Bulletin, Vol. 6, 1975, pp.53-73. Leys sees development of 'autonomous local capitalism' in the attempts to promote informal sector. See C. Leys 'Interpreting African Underdevelopment : Reflection on ILO Employment, Incomes and Equality in Kenya', African Affairs, 1973, pp.419-429. For Bose, (op cit. 5.2) the differences between the two sectors can very well be compared with those between the mother country and colony, characterised by 'unequal exchange' under colonialism and neo-colonialism.

such neutral terms like the "upper" and the "lower circuits" of the economy<sup>13</sup> or "firm centred economy" and "bazaar type economy"<sup>14</sup> which succeed in distinguishing the two sectors in a particular case and for a particular purpose, but do not help in evolving an analytical scheme of classification with general validity.

Among the rather vague distinctions, the one using "modern" and "traditional" dichotomy has been used most often in literature on development. Basically, it seems that the dichotomy refers to the technology used rather than organisation of production.<sup>15</sup> But, probably following the Arthur Lewis lineology of development models, the dichotomy also is found to subsume organisation, including mode of production, quite often. In most cases, however, the terms "modern" and "traditional" have been used vaguely without giving any precise meaning to them, and it has more or less been taken for granted that the audience know what is meant. In effect, the disaggregation of economy into the "traditional" and "modern" sectors have come to be identified with agricultural and industrial sectors of a developing economy. While the dichotomy may be well suited for

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13. Milton Santos, The Shared Space : The Two Circuits of Urban Economy and Their Spatial Repercussions, London, Methuen, 1975.
  14. Clifford Geertz, Peddlers and Princes : Social Change and Economic Modernisation in Two Indonesian Towns, Chicago and London, University of Chicago Press, 1963.
  15. S.V. Sethuraman, "The Urban Informal Sector : Concept, Measurement and Policy", International Labour Review, July-August 1976, p.72.

such a disaggregation, it is illadopted, as pointed out by John Weeks,<sup>16</sup> for studies on the urban economies of the less developed countries. The classification in practice tends to include all "enumerated" labour force in the "modern", and all "unenumerated" or "residual" labour force in the "traditional" sector; and enumeration as such is no valid basis for labelling activities and labour force with value-loaded titles. For, the use of "traditional" as a label for "unenumerated" suggests that the concerned sector is necessarily non-dynamic, and by implication, the "modern" sector is inherently dynamic. Louis Emmerij objects to the use of "traditional", as a term of disparagement, for, he feels that it is the product of an alien culture that sees "tradition" as detrimental to development rather than an integral part of nation's culture and identity.<sup>17</sup>

## II. The Informal Sector

In view of the above limitations of the earlier classifications, some of the observers have argued for the use of formal-informal sector dichotomy as a meaningful and convenient method of analysing the structures of urban economies.<sup>18</sup> Formal-informal sector dichotomy has evolved mainly out of the widespread concern of research makers and policy makers for the small and

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16. John Weeks, "Policies for Expanding Employment in the Informal Urban Sector of Developing Economies", International Labour Review, January 1975, p.2.

17. Louis Emmerij, op cit. p.202.

18. John Weeks, op cit. p.2.



unprotected producers in the urban economies, who on account of their disadvantaged position are unable to derive the benefits of development and contribute to the process of development to the full extent of their potential. Yet they are found to constitute a substantial part of the urban economic activities in towns and cities of developing countries and are engaged in the production of useful goods and services.

The formal-informal sector dichotomy was first used by Keith Hart in a study of urban Ghana.<sup>19</sup> The study identified a number of income and employment generating activities in the "unenumerated" sector of urban settlements. The workers engaged in them mainly worked as self-employed, as against the wage labourers of the "enumerated" sector; the new entrants to the urban labour market, particularly migrants from rural areas were forced to work in the informal sector partly due to lack of adequate opportunities in the formal sector and partly due to the workers' lack of skills and experience required for the jobs in the formal sector. The terms, informal income generating activities, unorganised sector, unenumerated sector, self-employed individuals and urban proletariat are used by Hart in his study more or less alternately and interchangeably.

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19. Keith Hart, "Informal Income Opportunities and Urban Employment in Ghana", Journal of Modern African Studies (London), March 1973, pp.61-89. For a critical review of the literature on the concept of informal sector, see Jan Breman, op. cit. pp.1870-1875.

The ILO-UNDP Employment Mission to Kenya adopted the term "informal sector" for analysing the employment situation and for working out a strategy for employment generation in Kenya.<sup>20</sup> According to this study the informal sector has the following characteristics : easy entry for the new enterprises, reliance on indigenous resources, family ownership, small scale operations, unregulated and competitive markets, labour intensive technology and informally acquired skills of workers. The formal sector has the obverse of these characteristics. It is the enterprises and not the individuals that are classified into the formal and informal sectors, which is one positive step ahead in clearing the confusion in classification; but the basis of classification into two sectors still remained vague.<sup>21</sup> At some points, the report included mainly squatter area enterprises as belonging to informal sector while at other the report appears to include all enterprises not recognised by the Government, in it. Further, while the characteristics proposed are particularly appropriate to Kenya, they appear to be less relevant to the general case.<sup>22</sup>

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20. ILO : Employment, Incomes and Equality : A Strategy for Increasing Productive Employment in Kenya, Geneva, 1972.

21. Cf. Sethuraman, International Labour Review, 1976, op cit. pp.71-72.

22. Ibid. p.72.



John Weeks attempted to provide an analytical base to the highly descriptive nature of the distinction between formal and informal sectors. According to him, the distinction is based on "the organisational characteristics of exchange relationships and the position of economic activities vis-a-vis the State. The nature of exchange relationship is primarily a consequence of the economic insecurity of operations in the informal sector, which, in turn, is a direct consequence of the latter's limited access to the resources of all types".<sup>23</sup> In his scheme of classification, position of enterprise vis-a-vis the State emerges as the main distinguishing feature between the two sectors. All government activities fall in the formal sector. The formal sector private enterprises are officially recognised, fostered, nurtured and regulated by the State. According to Weeks, the official favours to the formal sector enterprises take many forms : restrictions of competition and reduction in risk and uncertainty through tariff and quota protection for import substitution industries, tax rebates and holidays, low interest rates, selective credit controls and licensing of operations. Restricted competition, the privileged access to resources such as foreign technology, foreign exchange and local capital together provide disproportionately high rewards from operating in this sector.<sup>24</sup> Operations in the informal sector do not carry these benefits,

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23. John Weeks, op cit. pp.2-3.

24. Ibid. p.3.

they are outside the system of official regulations and benefits; have no access to formal credit institutions and foreign technology. Some times, operations in this sector are carried out, illegally, for the official limitations make it difficult for informal sector producers to have legal access to certain activities which are performed by enterprises in the formal sector with legal sanction.

It is this system of privileged access to resources according to Weeks that has led to certain characteristics of the formal sector : large-scale of operations, capital intensive techniques, and high wage rates and salary scales. The private formal sector is also often characterised by foreign ownership and imported technology and intermediate goods, and it usually produces for the sophisticated market. The informal sector, on the other hand, deprived of privileged access to resources, is characterised by small scale operations, labour intensive techniques, low levels of incomes and indigenous ownership.

The above distinguishing characteristics of the two sectors are also highlighted by Heather and Vijay Joshi while distinguishing between organised and unorganised sectors in Bombay under the three major heads : market structure, technology and relationship with Government.<sup>25</sup> We find that the

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25. Heather and Vijay Joshi, op cit. pp.44-46.

various characteristics regarding size, technology, ownership, product market, labour market and incomes are enumerated as characteristics distinguishing informal sector from formal sector in all attempts to analyse the former. John Weeks, however, seems to argue that the basic source of these differences lies in the government system of regulation. Validity of this proposition seems rather doubtful. Variety of production organisations is a universal and inherent characteristics of any economy irrespective of the degree and nature of state intervention. The small-large differences arise primarily due to the reasons of private ownership and technology, and the market system of production tends to make the differences sharper by rendering competition increasingly imperfect and leading to the emergence of oligopolistic and monopolistic situations. Differential access to private resources in itself is an adequate condition for increasing inequalities, polarisation of scale and organisation of production into extremely large and extremely small; the State regulation of production, and distribution of certain resources could, of course, lead to an accentuation of the cleavage.

The distinction based on State recognition and regulation, however, seems more relevant if one is interested in analysing the dualistic structure of the urban labour markets. Again illustrating the point from the Indian situation, the distinction between the formal and informal sector employment

at least in the manufacturing sector can be made, on the basis of whether the employing enterprise is registered under the Factories Act or not. For, once the enterprise is a registered Factory, the conditions of work get regulated. The registration is obligatory as size of employment reaches 10 workers with use of power and 20 workers without use of power. The recruitment, working conditions, hours of work, leave, payment of wages, dismissals, etc. are not formalised in the case of non-Factory organisations. As the distinction is based on size of employment and security of job, unionisation is also a characteristic only of the Factory labour force. Thus the formal sector workers have a 'protected' labour market, while those in the informal sector are exposed to uncertainty and whims of the employers. Mazumdar has brought out the distinction sharply, focussing on the fact that entry into the informal sector labour market is unrestricted while that in the formal sector labour markets is restricted by artificially raised hiring standards, norms and procedures.<sup>26</sup>

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26. Dipak Mazumdar, 'Notes on Urban Informal Sector', op cit. The hypothesis of easy entry to informal sector is, however, contested by Jan Breman (op cit. p.1907), on the basis that many activities in this sector are found to be dominated by a cohesive group each, and connection with someone in this group is necessary to get entry into these activities. Also see M. Bienfeld 'The Self-Employed of Tanzania', IDS Discussion Paper 54, Sussex, 1974 and McGee, op cit. pp.34-35.

It may, however, be mentioned that the formal and informal nature of labour market sometimes cuts across the two types of enterprises - Factory and non-Factory. The Factory enterprise also have some workers engaged in them recruited on an informal basis and working on irregular basis. The case of sizeable number of casual workers, along with a core of stable regular workers, in the Cotton Textile Industry in Bombay, as brought out in a study by Mazumdar, is a pertinent example of this phenomenon.<sup>27</sup> There is need to distinguish, therefore, between the informal sector labour market and informal labour market in the urban economies. The scope of the former would be confined to the workers in informal sector establishments, howsoever defined, and the latter would, in addition, include casual, contract, and irregular workers in the formal sector establishments.

### III. Characteristics of Informal Sector Units

The foregoing discussion of the bases of distinction between formal and informal sector, and characteristics of informal sector does not enable us to come to a precise definition of the informal sector. We are still at a stage where we could do nothing substantially more than repeat

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27. Dipak Mazumdar, "Labour Supply in Early Industrialisation - The Case of the Bombay Textile Industry", Economic History Review, August 1973.

what Sethuraman has said : "The informal sector, as its name suggests, is not formal in its character".<sup>28</sup> But we do have a number of variables characterising the informal sector, either derived on a priori basis or from empirical studies of several urban areas in developing countries. It must be mentioned that the main focus of the analysis has been on suggesting policies for mitigating the disadvantages of the informal sector, primarily manifest in its lack of access to the resources of all kinds : capital, finance, modern technology and skills.<sup>29</sup> The concern has been particularly voiced in documents and reports prepared under the World Employment Programme of the International Organisation, beginning with the report of the Employment Mission in Kenya, which popularised the concept of informal sector in employment and development literature. The logic for concern for development of informal sector, as expressed in the Kenya Report, is summarised by Sethuraman, in following words : "The basic reason for the introduction of this term in Kenya Employment Mission Report followed from the new widely recognised fact that it takes a very long time for the benefit of general

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28. S.V. Sethuraman, "The Informal Sector in Developing Countries : Some Policy Implications", Social Action, July-September 1977, p.196.

29. John Weeks, op cit.; Heather and Vijay Joshi, op cit.; S.V. Sethuraman, "The Urban Informal Sector in Africa", International Labour Review, November-December 1977, p.344.



development policies to trickle down to the poorest sections of the population. Effective development needs to be focussed directly on a specific "target" population and the Employment Mission considered that perhaps the most important of such target group in urban areas was what it described as the informal sector".<sup>30</sup> The identification of the characteristics of informal sector enterprises have accordingly followed this concern, and have mostly been derived from the empirical studies conducted in various cities in developing countries.<sup>31</sup>

Thus "informal sector" is a convenient way of designating a segment of the economy having certain characteristics which lead to unfavourable conditions for the growth of enterprises and activities operating in this segment. The term has no specific analytical meaning in itself; it is used "for lack of better alternative".<sup>32</sup> It has an advantage over the terms derived from earlier dichotomous classification of activities, such as "unorganised" "traditional" etc., to the extent, due to its greater vagueness it becomes more

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30. S.V. Sethuraman, International Labour Review, July - August 1976, p.69.

31. A number of studies, besides the Kenya Report have been prepared under the ILO auspices with this end in view; e.g., Harold Lubell, op cit.; A.N. Bose, op cit.; Heather Joshi, Harold Lubell and Jean Mouly : Abihdan : Urban Development and Employment in Ivory Coast, ILO, Geneva, 1976; Kalmann Schaefer : Sao Paulo, Urban Development and Employment, ILO, Geneva, 1976; S.V. Sethuraman : Jakarta : Urban Development and Employment, ILO, Geneva, 1976.

32. S.V. Sethuraman, International Labour Review, 1976, op cit., p.75.

inclusive and flexible to suit different empirical situations. Let us, therefore, examine the various reported characteristics of the informal sector from the viewpoint of their suitability (i) to demarcate the 'informal sector' as a distinct analytical and empirical category, and (ii) to provide a basis for supportive policy measures with a view to helping the disadvantaged. The following are the most often observed features identified as characteristics of informal sector in the studies on the subject.

#### 1. Small Size of Operations

All observers agree that the informal sector consists of small establishments. The "smallness" may have differing connotations in different empirical situations. The demarcation is generally made on the basis of size of employment. On the one hand, it is sometimes suggested that single worker establishments, and those with only self-employed and own-account workers, form the core of the informal sector.<sup>33</sup> On the other hand, it is felt that this would unnecessarily restrict the scope of informal sector, as many of the establishments using hired labour also reveal the disadvantaged characteristics. From the empirical viewpoint, 'enumeration'

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33. Cf. Hart, *op cit.* p.66, McGee, *op cit.* p.33, and M. Bienenfeld, "The Self-Employed of Tanzania" Discussion Paper 54, May 1974, IDS, Sussex Introduction (iii); Brenman (*op cit.* p.1873) disputes this proposition on the basis that self-employed professionals hardly fit in the informal sector and poorly paid wage employees of small establishment are no better off than self employed.



or 'registration' has been considered a good base for the distinction between the two sectors; and it is well known that the regular official enumeration and registration is applied to the units above a given employment size only. It is on this basis that a general cut-off point of size of employment is suggested as 10 workers. Small size of operations is considered a necessary condition for inclusion of an enterprise in the informal sector, because "smallness" is usually accompanied by several other attributes which make such enterprises disadvantaged.<sup>34</sup> To the extent this association is not observed, a policy of protection and support to informal sector defined as small sector would not meet its basic purpose. For example, if small enterprises have high capital intensity, high rate of return on capital due to low wages, and an assured market among the higher income groups and foreigners, for they may be producing limited quantity of luxury and art goods with inelastic demand, the size as a basis of assistance would not serve the employment or distribution objectives on which the entire concern for informal sector is based.

## 2. Informal Structure and Family Ownership

Informal sector enterprises obviously do not have a formally structured organisation; there is limited functional

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34. Sethuraman : 'The Urban Informal Sector : Concept, Measurement, and Policy', op cit., p.76.

division of labour and specialisation; and most of the management and supervisory and sometimes some of the production, functions are performed by the proprietor. There could also be extensive use of family labour. All these characteristics, however, are not always found to go together. Small size itself makes if necessary and possible to run an organisation without a structured division of labour and management hierarchy; even the organisations with wider ownership and using hired labour may reveal these characteristics if their size of operations is not large. On the other hand, large, even though family owned, enterprises cannot be run on the basis of informal and unstructured organisation, and undefined functional division of labour. Structure of organisation is thus mainly a function of size and is not necessarily related with the pattern of ownership. The distinction between the private formal and informal sector on the basis of indigenous and foreign ownership is also not valid in countries, such as India, where the indigenously owned sector constitutes a major part of the organised industry.

### 3. Non-Modern Technology

Similarly, distinction between formal and informal sectors on the basis of use of imported foreign technology,<sup>35</sup> and adopted and indigenous technology appears to represent

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35. Heather and Vijai Joshi, op cit. p.45.

a rather extreme viewpoint. Technology used in large textile mills in India can no longer be considered foreign, yet to include these mills in the informal sector because they use indigenous technology would make an absurdity of the informal sector concept. The intent of using technology as variable in distinguishing informal from formal sector is to highlight that the informal sector units use labour intensive, predominantly manual, low productivity techniques of production, as compared to capital intensive, highly mechanised and high productivity ones used by the formal sector units. The question of imported versus indigenous technology is rather incidental to the issue, and is perhaps used to deliberately exaggerate the helplessness and disadvantages of the informal sector.

From the policy viewpoint, it is also important not only to identify the technology, but also reasons for its use or non-use in a particular sector. In the first instance, the technology varies basically due to the nature of the product, and only partly with the size of enterprises within the same product group. Secondly, an informal sector producer may not use capital intensive, modern technology, either because it does not have access to it or because it does not suit him in the given relative cost position of capital and labour as he hires labour at a much lower wage rate than the formal sector employers. Providing assistance

for technological improvements would help the informal sector units in the former situation; but not in the later.

In the informal sector literature, the technology used in this sector seems to have been presented both as an asset and a liability : one of the bases on which a case is made out for a favourable treatment of this sector is its labour intensive technology; and one of its main disadvantage is also found to consist in the low productivity of its technology. Here lies a basic contradiction in terms of policy towards this sector : preserving its technology would imply support to low-efficiency techniques; and modernising it would imply losing on the employment advantage of this sector, or even wiping out the informal sector to the extent, a non-modern technology is considered as one of its essential characteristics. Preservation of existing technology would be quite appropriate if it is labour intensive and also generates reasonable levels of productivity and earnings.<sup>36</sup> In other cases, a trade-off is implicit and will have to be decided on the basis of the policy makers' preference for low-productivity/earning employment or higher productivity.

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36. This is reported to be the case in some African countries and also in Jakarta, by Sethuraman, in 'Urban Informal Sector in Africa', International Labour Review, November-December 1977, p.347, and Social Action, op cit., p.203.

#### 4. Lack of Access to Government Favours

In the formal-informal sector distinction the informal sector is portrayed as having rather rough treatment in the hands of the government. First, only formal sector enterprises are reported to have access to resources controlled and distributed by the government : thus advantages of organised capital market, bank finance, foreign technology, imported raw material, protection from foreign competition, etc. are not available to the informal sector enterprises.<sup>37</sup> Not that these facilities are officially denied to the informal sector units; they are not able to avail of them because of their meagre material resources. Even when the governments have tried to mitigate some of their disadvantage by giving them a preferential treatment,<sup>38</sup> the benefits have not gone to the smallest of the informal sector establishments, for the reasons of their inability to cope up with the official procedures for obtaining them.<sup>39</sup>

The informal sector units have also been found to enter certain activities requiring legal permission without

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37. John Weeks, op cit., p.3; Heather and Vijay Joshi, op cit., p.46.

38. Eg. in India, as also pointed out by John Weeks in op cit., p.5.

39. T.S. Papola, Small Scale Industries in U.P., GIDS Occasional Paper No.2, Giri Institute of Development Studies, Lucknow, (Memo) 1978). Some of the observes feel that programmes of stimulating industry in the informal sector are of little practical use. See Gerry, op cit. p.74 and Bose, op cit. 3.33-3.35.

obtaining it or to acquire certain inputs requiring license from the illegal market, as "a consequence of official limitation of access to the formal sector".<sup>40</sup> "The bureaucratic procedures which have to be followed to obtain scarce inputs, such as foreign exchange, are complicated enough to put them at a serious disadvantage or force them into riskier black market transactions."<sup>41</sup> Similarly, many of the informal sector establishments operate on pavements, crowded streets, and odd places due to lack of suitable space that can be had within the means they possess, and the government quite often forces these "enterprises to move on account of overcrowding, health considerations, traffic congestion, environmental or aesthetic factors, or because the land they occupy does not belong to them".<sup>42</sup> Consequently, they feel insecure in these operations and are afraid of the harassment and punishment by the public authorities. The governments' attempts to enforce certain regulations are naturally considered by these enterprises as "hostile" conditions making their operations difficult.<sup>43</sup>

It seems that in their enthusiasm to support the expansion of the informal sector, some observers have tended

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40. John Weeks, op cit., p.3.

41. Joshi and Joshi, p.46.

42. Sethuraman, 'The Urban Informal Sector in Africa, op cit., p.345.

43. Sethuraman, Social Action, op cit., p.198.



to undermine certain other important policy considerations. Even if it is granted that the informal sector employs people, produces useful goods and services and provides income generating opportunities particularly to the poorer groups of population, the question of public intervention in economic and social matters cannot be decided upon only on this consideration. Nor can laws and regulations enacted with wider socio-economic considerations in view, be allowed to be defaulted because the defaulters are disadvantaged. Many a time, the certain activities may be carried out illegally not necessarily because of the disadvantaged position of the operator but because of higher profitability of operating illegally than with legal sanction. Dealing in quota, licenses, foreign exchange are examples of this type. It is not so much the lack of access to and conditions allocated by the government through licensing regulation that makes the informal sector units disadvantaged, as the problems they face in availing of the facilities and resources which are made available to everyone without prior permission from the government. Bank credit, space, electricity, water etc. are the examples of such services and inputs which are not supplied on a government licence, yet the informal sector units are not able to avail of them adequately. The situation is a result of uneven distribution of private resources, which seems to directly determine the distribution of the benefits of public resources as well. It is a basic contradiction of a private enterprise

economy characterised with extreme extent of inequities, that even the State measures to reduce them often result in accentuating them.

#### 5. Competitive and Unprotected Product Market

It is also not always true that the informal sector produces goods and services of general use while the formal sector enterprises predominantly cater to the demands of high income and sophisticated sections of population and foreign markets; nor do all informal sector enterprises operate in a competitive market and all formal sector enterprises in an oligopolistic and protected market.<sup>44</sup> Personal services, of course, are one of an important example of an informal sector activity catering to the needs of high income groups.<sup>45</sup> Then there is the whole range of artistic handicrafts produced in the informal sector in a country like India. Textile clothing, washing soap, matches and many other items of mass consumption are produced both in the formal and informal sector. The formal sector products, of course, have an advantage of brand names and better marketing networks, which render the market of each firm in this sector somewhat non-competitive; but a degree of competition does

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44. The features of product market have been highlighted as important distinguishing characteristics of the two sectors by Joshi and Joshi (op cit., p.45) and John Weeks (op cit. p.3).

45. Joshi and Joshi pp.44-45.



exist among the producers within the formal sector. A large number of formal sector units, other than multinationals, public sector enterprises and large private indigenous enterprises, operate in a highly competitive market as they are very large in number and none is large enough to influence the market. The producers of artware and handicraft goods in the informal sector on the other hand, operate in a market mostly devoid of any competition; the actual producers, viz., the workers, in these activities, of course, do not get adequate share of the benefits of the non-competitive market, as contractors and middlemen usurp most of the surplus.

Still, it is, by and large correct to surmise that the informal sector establishments are not able to realise the same revenue per unit of their output from the market as do the formal sector producers. The difference is not so much on account of the nature of demand for the product and the nature of market faced by the firms, but the relative lack of holding capacity and marketing arrangements available to the informal sector enterprises; which can again be ascribed to their small scale of operations and meagreness of resources. They sell to whatever buyers are at hand at the time their product is ready for sale; and, therefore, are not able to realise full value of their product.

## 6. Unprotected Labour Market

The labour market characteristics of the two sectors, contrast more sharply than any other characteristic used as a basis for dichotomous classification of the urban economic activities. The labour market for the informal sector is unregulated and highly competitive on the supply side, with absolute freedom to entry, while that in the formal sector is regulated and has entry restricted on the basis of standard hiring norms and formalised hiring procedures. The supply of labour in the informal sector consists of mostly new entrants in the labour markets - in-migrants or young persons entering the labour force, who aspire for jobs in the formal sector, but finding the opportunities for it limited and entry restricted, start doing something or the other in the informal sector either as self-employed, part time workers, apprentices or full time workers in small establishments. Consequently, the informal sector bears the brunt of excess labour supply which tends to lead to a situation of significant underemployment<sup>46</sup> and depressed wages in that sector, while the formal sector workers do not feel the pressure of excess supply, as their wages and conditions of work are regulated. Their jobs are secure and a level of wages assured, while those in the informal sector suffer not

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46. Mazumdar, 'Notes on the Informal Sector', op cit.

only from low wages, but also vicissitudes of market fluctuations and whims of their employers. A labour market thus functions in a free competitive sense in the informal sector, wage rates get set not only on the basis of labour market conditions, but also to clear the market,<sup>47</sup> while wages in the formal sector establishments are rather insensitive to the labour market conditions.

Earnings in the informal sector are relatively very low as compared to the formal sector, almost half or even less; yet they are found to be still higher than what the migrants from rural areas could have earned at the place of their origin.<sup>48</sup> Basically, it is the formal sector wages and conditions of work that attract migrants to the city, but it is the informal sector which holds them there. The slow pace of growth of the formal sector results into lack of opportunities for the informal sector workers to move up to the formal sector, and thus the dichotomous segmentation of the urban labour markets persists. A faster growth of the formal sector would, however, tend to reduce the differentiation between the two labour markets, to that of degree rather than of substance.

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47. T.S. Papola, "Wage Determination in the Unorganised Sectors in Urban Areas : A Framework for Analysis", Gujarat Economic Conference Papers, Gujarat Economic Association, Ahmedabad, 1976.

48. Sethuraman, Social Action, op cit., p.203.

#### IV. Issues in 'Informal Sector Strategy'

The above discussion on the various attributes of the urban 'informal sector' suggests that it is difficult to identify it as a distinct analytical category; the various characteristics attributed to it are not necessarily consistent with each other, nor are they to be found universally in different empirical situations. Nor do, these characteristics provide a clear identification of the 'informal' sector as the only and certainly disadvantaged sector deserving supportive policy measures. Yet it is an undeniable fact that a sizeable segment of the urban economies, consisting of self-employed individuals, and small establishments, engaged in the production of useful goods and services and providing employment to a substantial part of the urban labour force, suffers from severe technological, marketing and other handicaps, and, is not able to derive the benefits of public services and support mechanism; and is, consequently, characterised by low productivity and earnings of those engaged in it. Most of the urban poor have their livelihood in this sector. From the policy viewpoint, which has been the main motivation behind the development of the concept of informal sector, this sector needs to be identified and suitable measures need to be devised to enable it to raise its productivity and earning levels, and to grow fast with a view to absorbing the fresh entrants in the urban labour market, either as a result of natural population growth or in-migration from rural areas.

It is observed that the features attributed to the informal sector are generally associated with the lack of adequate resources manifest in the small size of operations. As a matter of fact, the disadvantages ascribed to the informal sector are primarily due to the small size of establishments.<sup>49</sup> Therefore, if the informal sector is devised as a concept to identify the "target group" for policy purposes, the most practical way of identifying it is to start with the smallest of the enterprises, say those employing upto 10 workers, selfemployed or hired.<sup>50</sup> Other characteristics of these enterprises attain relevance depending on the policy questions being considered and policy measures being suggested, which means that it would be difficult to evolve a uniform policy for all types of enterprises in the informal sector.

The major policy questions in relation to the informal sector are : to what extent this sector is capable, provided appropriate policies are adopted to mitigate its disadvantages, to provide productive employment to increasing number of urban job seekers ? Will not the policies to promote growth of informal sector enterprises lead to their 'formalization' and thus disappearance of the advantages that they offer as

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49. Sethuraman, 'The Urban Informal Sector : Concept, Measurement and Policy', op cit., p.76.

50. Sethuraman has considered it as the basic element in the list of criteria for identifying informal sector enterprises (Ibid. p.81.)

small informal establishments? Should the strategy be that of promoting informal sector in preference over the formal sector or should it involve an integrated development utilising the potential of linkages between the two sectors?

Ultimately, is informal sector thought of as an instrument of growth and employment generation in the short-run only or a dichotomous model of urban economy is thought as a long term policy goal as well?

To the extent the disadvantage of the informal sector consists primarily in the lack of its access to some basic inputs like space, electricity, and working capital finance, and in their inability to market their product profitably, the expansion of this sector with appropriate government help in these respects, would lead to increasing productive employment. But if their disadvantage lies basically in technological backwardness, their salvation may be in modernisation of technology which may result in reduction in employment potential per unit of capital and output. Further if in certain activities, it is the small scale of operations that is technologically leading to the non-viability of the enterprise, scale enhancement and consequent formalisation would have to be attempted. Next, a sizeable segment of the informal sector is dependent on the formal sector for marketing of its product and acquisition of technology. A

strategy of independent growth of informal sector, without utilising the intersectoral linkages<sup>51</sup> may lead to the decline of this segment of the informal sector. A growth pattern not linking the two sectors, besides ignoring opportunities for growth to some extent, would also tend to further develop the schism between the two sectors and thus leading to further cleavage between the earnings and conditions of work in the two sectors.

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51. For a discussion of intersectoral market and technological linkages, see, Susumu Watanabe, Technological Linkages Between Formal and Informal Sectors of Manufacturing Industries, World Employment Research Programme, Working Paper 34, 1978; and T.S. Papola and R.S. Mathur, Intersectoral Linkages in Manufacturing : A Study of Metal Engineering Industry in Kanpur, Giri Institute of Development Studies, Lucknow and ILO, Geneva, 1979.